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UNCLAS SECTION 01 OF 02 SHANGHAI 000399

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SUBJECT: CHINESE AUTHORITIES NERVOUS OVER AIG FINANCIAL CRISIS

REF: SHANGHAI 363

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¶1. (SBU) Summary: According to an American International Group (AIG) General Insurance Company China high level official in Shanghai, Chinese regulatory authorities are concerned about AIG's stability in China. The State Council ordered the China Insurance Regulatory Commission (CIRC) to request an accounting from AIG China and American International Assurance (AIA) China on the ability of the two companies to insure Chinese policies. Despite concerns, the official emphasized that AIG and AIA are solvent in China. There have been numerous inquiries from the public, but thus far no demand for policy cancellations. However, AIG China has experienced numerous cancellations and suspension of contracts with other companies because of AIG's drop in credit rating in the United States. AIG China also fears that the turmoil at its U.S. parent company will give a pretext for CIRC to deny pending applications for additional branch offices. End Summary.

¶2. (SBU) According to the AIG official in Shanghai, CEOs of AIG China and AIA China were called to Beijing on Wednesday, September 17 to report on the companies' financial status. The official said both companies received summons on September 16 from the China Insurance Regulatory Commission (CIRC) at the behest of the State Council and were surprised by the speed and depth of the request made by Beijing. In the summons notification, CIRC detailed very specific questions about AIG and AIA operations and risks to policy holders in China and wanted assurance that all policies written in China would be honored.

¶3. (SBU) The official said that although AIG China is financially solvent, there was very little the CEO could report to CIRC about the status of the parent company until Wednesday morning after the announcement of the US\$ 85 billion bailout announced on Tuesday in the United States. Although the AIG parent company faced liquidity problems, the official emphasized that AIG China and AIA China do not have the same liquidity issues. AIG China is "completely insulated from what is going on in the United States, and the financial problem is solely at the corporate financial level." Although Chinese regulations set a minimum capital requirement of RMB 200 million for wholly foreign owned insurers, AIG China currently has RMB 600 million

set aside for the capital requirement. The official assured that this is more than enough for AIG China to remain solvent. The problem is the "perception" that the parent company is failing.

#### Heavy Fallout Already Being Felt

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14. (SBU) The official noted that, unlike Singapore and Hong Kong, policy holders in Shanghai or elsewhere in China have not requested a cancellation of their policies. The lack of public reaction is because "mainland Chinese do not yet have the sophistication and experience with insurance." However, the official said there were many inquiries from the public and did not rule out the possibility of some policy holders cancelling policies as news of the reaction in Hong Kong and Singapore spread. The immediate implications are that partner businesses have called to suspend or cancel contracts and other cooperation as AIG's credit rating plummeted. The official explained that many of these contracts are specifically contingent on the company's credit rating, and AIG, along with AIA, will face some tough questioning from partner businesses over the next few days.

#### Implications for AIG China's Expansion

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15. (SBU) According to the official, the Central Government is likely to nix the pending applications for two additional AIG branches in Zhejiang and Jiangsu provinces. CIRC has been "reluctant" to provide national treatment to foreign insurance providers, and is "itching" for an excuse to deny requests for greater access. As a direct result of the May 2007 Strategic Economic Dialogue, AIG received permission to establish a wholly foreign owned enterprise (WFOE) in July 2007. Subsequently, the WFOE applied for 3 branches, one of which was approved to open in Beijing. CIRC told AIG it would wait to see how the Beijing

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office fared before approving the other two applications. The official now believes AIG's financial crisis will provide the justification for CIRC to deny AIG China's license applications based on the "stability" of the AIG parent company. In addition, the official complained that CIRC does not take the same approach to domestic insurance companies that can concurrently open multiple branches with relative ease. There is also fear that CIRC will increase scrutiny over AIG and other foreign insurer operations, to the benefit of domestic insurers.

#### AIG - An American Company with Shanghai Roots

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16. (U) AIG, founded in Shanghai in 1919, is now China's largest foreign general insurance company. During World War II, the company moved its headquarters to New York and was the first foreign company to resume operations in Shanghai after the war ended. The Shanghai office was closed again in 1950 due to political instability. In 1992, AIG was the first foreign-owned life and non-life insurance business to receive permission to once again operate in China and opened a branch AIA office (AIA is an AIG subsidiary company). Currently AIA has 8 branches in China and AIG has three (Shanghai, Guangdong and Shenzhen). Since reentering the market, AIG, together with AIA, have been able to gain 40 percent of the market share for all foreign non-life insurance services. However, the official noted that this represents about 1 percent of the total insurance market in China (reftel). AIG also maintains a joint venture in China, AIG-Huaitai Fund Management Company.

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